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Repercussions of Economic and Social Factors on Pension Systems

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Abstract

Economic and social developments in recent years have left serious marks on pension systems. As forecasts for the following period are bleak, the need for uniting the efforts of public authorities with those of the business environment, research institutes and the academic community in order to identify viable solutions for both the present and the future, becomes increasingly obvious. Together they can identify remedies and contribute to the popularization of a problem whose consequences, once known, can be counteracted.
The paper drafted, by studying the literature, confronts a number of common issues faced by pension systems in the current period and emphasizes the possibility of passing them on to the future, but with much more severe consequences.

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Keywords: labour market, jobs, wages, contributions, pensions

1. Introduction

Pensions are, as shown in a press release of the European Commission, the main source of income for about a quarter of the EU population, but their conditions and level depend on the organization of pension systems specific to each Member State.

The ultimate goal of everyone should not be only to grant the pension in itself, but also to ensure an adequate income from pensions, which would enable the recipient to live a decent life and to have economic independence [1].

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Achieving such a goal does not depend, especially in the case of public pension systems, only on the payment of the obligations established by the legislator in the responsibility of the employee and of the employer during the period and at the levels provided by law, or on the fundamental solidarity between generations and within the same generation, but also on the economic and social conditions within which the system develops and operates, as well as on other factors such as political, demographic, cultural ones etc., specific to each state.

From the vastness and complexity of the factors invoked, we will further analyze, succinctly, some issues pertaining to the economic environment, which could affect both major public pensions systems, as well as private ones. The basis of the analysis is the existing pension system organization framework as well as present and potential future problems that states could face in the payment of social security obligations for their citizens, in this case the pension.

2. Influences of the Economic Factor on Pension Systems

The essence of the effects of the economic factor, whose symptoms were amplified by the economic and financial crisis, is reflected in the White Paper, drafted by the European Commission in 2012, according to which "Weak economic growth, budget deficits, debt burden, financial instability and low occupancy prevents pension systems from fulfilling the promises with regard to pensions" [2].

In essence, the economic factor is reflected in insufficient income from which pension systems pay pensions payable, essentially because of the low rate of contribution collection, the limited sphere of taxpayers, but also because of the low level of the base of contributions payable: income / funds from low wages => small pensions.

The value of individual contributions, subsequently quantified in pension points and the calculated pension respectively, shows the dependency of the retirees' income on previous income. Since contributions are calculated as a percentage of the salary, the final level of the pension will be directly linked to it and, as long as salary levels are low, the pensions will mandatorily follow the same trajectory.

Based on the previous idea, we consider that an employee with an average level salary will have a pension at the same level and consider, as working hypothesis, that the average wage represents a reasonable income that ensures a decent living. In accordance with those put forward, in order to find whether the ratio of the salary representing the pension could provide the recipient with a decent old age, we relate the average pension with the average wage. The results obtained show that a current retiree receives, within Pillar 1 (state pensions), a pension which slightly exceeds 1/3 of the average wage (Table1).

Table 1. The ratio of the average pension in the average wage

RON

Indicator	2007	2008	2009	2010	2011	2012
Average pension this month	399	593	711	739	773	778
Average salary	1,396	1,761	1,845	1,902	2,022	2,117
Pension/salary ratio	37.04	33.6	38.53	38.85	38.22	36.75

Source: INSSE; http://www.mmuncii.ro/ro/statistici

For comparison, in Europe, we relate the pension in June 2012 with the euro exchange rate in the same month (4.4626 lei / the euro), and we obtain a pension of € 174, a level which places Romania at the last but one average pension ranking in the European Union. Bulgaria is ranked last with € 145.

Without going into details about the expenses that a retiree has to make with such a pension, we cannot but ask: Is this an adequate pension? (OECD considers that the adequate average income from a pension represents 70% of the pre-retirement income. In the specialized literature it is called income replacement).

Doesn't a pension of this level increase the risk of poverty for its recipients? What will happen to those who receive the minimum wage (750 lei) and whose contributions are paid, obviously, depending on that salary? (The European Union uses a relative definition to measure poverty, namely "the number of people with an income below 60% of the national median equalized disposable income").

The questions are justified by the results of recent polls, which show that of the 5.5 million pensioners in our country, 3.5 million live below the poverty threshold. Also, it is noteworthy that inadequate pensions can generate unanticipated social pressure for ad hoc increase of pensions or a higher demand for other social benefits to replace income insufficiency.

At individual level, the solution for adequate incomes from pensions could come from the private pension funds in which, by developing a culture of savings, employees would be willing to invest. A special role in this respect is played by educational establishments and lifelong learning programs which may form the culture of savings by including certain financial education courses within training programs. The media could also contribute to this by disseminating, not only the risks that concern future pension incomes, but also the opportunities that people have to protect themselves. Private organizations that make the results of their studies available to the population as well as to public authorities are not to be neglected either.

Thus, the Aviva Group, in the study concerning the pension deficit (where, pension deficit is considered to be the difference between pension funds that consumers need for adequate living and the amount of money they expect to receive as a pension), shows the effort of saving that a person should make in order to secure an income which would allow a standard of living close to that before retirement. According to their calculations, a young man who is now 20 years old, should save € 1,300 / year or about 110 €/ month, for over 40 years [3].

Could, however, an employee materialize the desire to save under the terms of the current salary level? The attitude can be inferred, realizing the fact that for every individual, covering current needs constitutes the priority in the use of resources.

Since wage levels are based on economic results we can say that economic revival could turn into a "snowball"-type phenomenon, with positive effects reflected both in the creation of new work places and in higher wages, as well as in the receipt of adequate and sustainable pensions.

What could trigger the movement in the desired direction? A first step, perhaps the most important, could be revamping, investing in technology that brings about increased productivity. The development of competitive economic branches/sectors in international markets would also lead to the revival of Romanian exports into new markets, including the huge markets outside the EU. Economic revival, materialized in the creation of jobs with high added value and a corresponding salary level would absorb part of the working population for the education and training of which significant public funding would be consumed.

Since steps in the mentioned direction are uncertain and cumbersome, a way of increasing the number of taxpayers and hence the level of collected resources to the social security budget could be surfacing activities in the underground economy and legally employing the generated work places.

Legal employment of those working illegally would protect them against the current risks they are facing: the dependence on the goodwill of the employer, both with regard to wage levels as well as compliance with or granting of rights under the labour code, as, for example, time off or vacation. In addition, they would not be excluded from the social protection system and would no longer be exposed to dismissal without being granted the rights provided by law for situations where they could be confronted with insured risks: sickness, unemployment, disability, etc.

Moreover, by means of legal employment and inclusion in the pension system, workers coming from the illegal or informal economy are protected against future risks, since, if they can benefit from pensions, the possibility of confrontation with the risk of poverty or other situations related with it, is diminished.

Data released on the level of the economy not subject to taxation (29.6 percent of the GDP) lead to conclude that the application of mitigation measures (visible in the results) cannot be delayed. Although hard to quantify, social effects should not be underestimated, either. The practice of undeclared work and underreported wages is not specific only to Romania, but also to other Central and Eastern European countries, whose social security and tax systems are also affected [4].

Besides, the risk of failing to meet conditions required by law for pension benefit exists for young people who are legally employed, but part-time and temporarily (OECD, Outlook 2012).

The problems that young people are faced with on the labour market have not left the EC indifferent, either, who, within the Youth Opportunities Initiative shows that through fixed-term employment contracts, especially early in their careers, young people are in a permanent state of uncertainty due to the loss of employment risk and that through the segmentation of the labour market, they are converted into second-class workers, a fact that may reduce their career perspectives and may affect their career development [5].

The reduction of jobs and implicitly of taxpayers, employers and employees in the pension system, is reflected in the growing deficit of the social security budget, due to the low income earned compared to the increasing volume of expenditure incurred for the payment of pensions (Figure1).

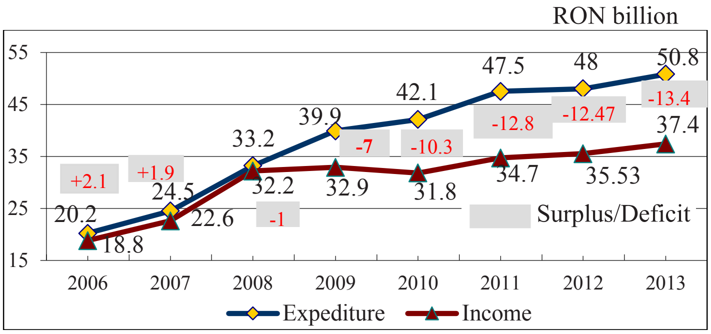

Fig. 1. The evolution of the social security budget deficit

Source: Fiscal Council, Report for 2011, Macroeconomic and Budgetary Developments and Perspectives, 2012

The data presented in the graph show that the first year that deficit was recorded, coincides with the year when the economic crisis started in Romania, respectively in 2008.

However, it should be noted that the deficits are not due only to the current problems of the pension system, but also to the measures taken in the 90s, when early retirement was resorted to in order to reduce unemployment. Moreover, since 1995, the PAYG system has permanently recorded deficits covered by transfers from the state budget (with the exception of 2006 and 2007, when economic growth resulted in the collection of sufficient revenues).

Other measures, which initially aimed at improving the situation of pensioners and employees and which later affected the sustainability of the pension system and increased deficit problems, are: reducing the social contribution rates, increasing the pension point to a level higher than the economic growth rate, but also channelling a part of the amount collected from Pillar 1 to Pillar II (privately administered). Added to them was the manifestation of the economic and financial crisis, reflected in the contracting of the labour market and hence in the decrease in the number of employed persons, in wage reductions and the freezing of the pension point.

The results of research, conducted by several national and international institutions aimed at the sustainability and viability of pension systems, reflect the unfavourable prospects for the Romanian pension system, as well as those of other states. Relevant for the undertaken analysis are the developments in pension expenditure in the GDP in several EU countries beginning with 2008 to the horizon of 2060, contained in the studies carried out at a European level (Ageing Report, 2012).

In order to support the ideas expressed with regard to Romania, the analysis is restricted to a number of countries with characteristics common to those of Romania, namely: they are part of the emergent states in Europe and offer opportunities for development of the labour market; they were received in the European Union during the last two enlargements, a situation that forces them to implement European directives on pensions; there are major differences between the pensions granted by them and have recently taken action to reform the public pension systems. The year 2008 was chosen as a basis for comparison, since it is considered to be the year when the crisis broke out in Romania and, at the same time, an election year for the Romanian people (Figure 2).

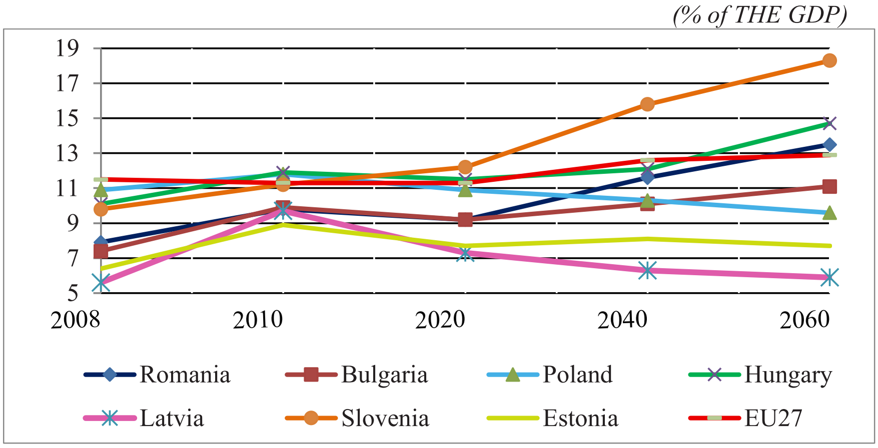

Fig. 2. Perspectives for the development of public pension expenditure
Source: The 2012 Ageing Report: Economic and budgetary projections for the EU27, Member States (2010-2060), European Commission (DG ECFIN) and the Economic, Policy Committee (AWG), 2012, p.101

As it can be observed, the value of pension expenditure incurred by 2010 compared to 2008, increased in all the states included in the analysis. Significantly, in the case of Romania, is that pension expenditure is below the European average, even after the increase of pensions made in the election year 2008.

According to data from The Ageing Report/2012, the tendency to increase pension expenditure is expected to be further maintained, except for some states where cuts are expected, such as [6]:

- states with higher growth estimates: Slovenia, an increase of 7.1% of THE GDP, and Romania where the weight will almost double, rising from 7.9% in 2008 to 13.5% in 2060, above the European average .
- states which are to decrease expenditure: Estonia with a decrease of 1.1% and Latvia, which stands out with an estimated reduction of -3.8% of THE GDP. As far as Latvia is concerned, it should be noted that the legal retirement age gradually increased to 62 years for men (in 2003) and women (in 2008).

Across all 27 EU countries, it is estimated that expenditure on pensions will increase by 1.5 percentage points between 2010 and 2060; in 2060 it could reach a level of 12.9% of THE GDP.

In conclusion, in order to not substantiate forecasts, all countries should join efforts to find alternative solutions to current models covering both pension schemes and the development, in a regional and global framework, of labour markets openness and freedom of movement of workers and capital (investments of pension funds).

3. Implications of the Social Factor on the Sustainability and Viability of Pensions

As with the economic factor, the social factor, which determines the ratio of retirees and employees in the economy, has major influences on pension systems in most EU Member States. In Romania, the data of the Ministry of Labour, Family and Social Protection and that of the National Statistics Institute (INS) show that after 1990, while the number of retirees increased, the employment rate dropped continuously. For relevance the evolution of the retirees-employees ratio between 2007 and 2013, a period during which the number of retirees exceeded that of permanent employees, having around 1.2 to 1.3 retirees per employee (Table 2), can be observed.

Table 2. Retirees-employees ratio between 2007 and 2013

thousands of persons

Indicators	2007	2008	2009	2010	2011	2012	January 2013
Number of retirees	5726	5685	5676	5675	5589	5.321,3	5.279,7
Employees in the economy	4,717.2	4,738.6	4,367.7	4,101.6	4,101.6	4311.6	4.345,6
Retirees-employees ratio	1.21	1.19	1.30	1.39	1.36	1.23	1,21

Source: www.cnpas.org.ro; http://www.mmuncii.ro/ro; INS, Press release No.69 /2012, (including retirees of the Ministry of National Defence, Ministry of Interior, the Romanian Intelligence Service)

If in terms of reducing the number of employees we can say that it has economic roots connected to the reduction of jobs, the increase in the number of retirees reflects a far more complex situation, which is caused, in its turn, by other causes aggravated over time.

The most important of these are of a demographic nature and consist in increased life expectancy, concurrently with declining birth rates, and the migration of a significant part of the working population towards other states which provide professional development and economic welfare opportunities.

While rising life expectancy indicates an improvement in living conditions and health status, the second issue produces concern being in fact an alteration of the spring of the society. The results are even more alarming if we take into account data provided by the National Institute of Statistics, following the population census of 2011, according to which the Romanian population decreased by 2 million, respectively to 19,042,936 people in 2011[7].

Likewise, the demographic forecast carried out by Eurostat (EUROPOP 2010), shows that, between 2010 and 2061, in Romania, the aging process will accelerate. Thus, as a result of low fertility rates the total population would be reduced by 20%, the population aged 20-65 would decrease by 37%, and the population over 65 years would grow by approximately 1.9 times. Negative forecasts are reinforced by the European Commission estimates that until 2050, more than 50% of Romania's current population will retire [8].

In order to raise awareness of the danger caused by aging, concurrently with declining birth rates, EU experts point out that the current crisis will be overcome by 10 times in intensity by the future demographic crisis of the pensions. According to their views, while the impact of the economic and financial crisis on pensions is on average of about 5% - 15% in the EU 27, the demographic crisis will double the burden on the younger generation, by increasing the dependency ratio by more than 100 % in several Member States [9].

In order to suggest the extent of the effects that fewer employees contributing to the pension system may have on the payment of pension benefits, the specialty literature uses the expression "demographic time bomb" [10].

As far as Romania is concerned, EUROSTAT estimates a tripling of the dependency ratio, increasing from 21.37% in 2010, to 64.77% in 2060.

To the specified causes another one can be added, namely migration which, together with the others, may have a profound impact on the labour market and the pension system. Thus, according to some assessments, the aging population phenomenon, doubled by the net migration phenomenon will increase the dependency ratio of the public pension system (number of pension beneficiaries compared to the number of taxpayers in the system) for Romania to 95.9% in 2050 [11].

The effects of migration on population number and structure may be inferred not only from the number of Romanians who decided to migrate abroad, amounting to 2.4 million, but also from the share held by the 20-39 age group, that is 62% of the total [12]. We notice that they are part of the age group composed of the population that is in the period of family formation and can contribute both to the demographic and the economic growth of the country. If we consider this perspective alone, we can conclude that the loss is double.

4. Conclusions

The crisis has shown the importance of the European approach to pension systems and that more efforts should be made to improve the efficiency and safety of pension schemes [13].

In the coming period, Romania should implement fiscal policies to stimulate the creation of quality jobs, legal employment, to increase contribution collection and eradicate corruption from the system.

The problems of pension systems, both public and private, highlighted even more by the economic and financial crisis, show the importance of regulations designed not only to protect taxpayers against potential risks, but also to involve them ever since their active period in the management of resources destined for retirement benefits.

Creating conditions for the development of the private pension system will come to support both the population and the economy through the financial resources generated and invested.

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